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ORIGINAL

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS OF PPL ELECTRIC UTILITIES CORPORATION AND PPL MONTANA LLC

PPL Electric Utilities Corporation and PPL Montana LLC commend the Board for its decision to receive public comments on major rail consolidations and the present and future structure of the North American Railroad Industry. The broad interest generated by the Board's decision instituting this proceeding demonstrates the importance of the issues presented, and indicates the widespread concern among shippers, railroads, rail labor, governmental interests and others over the developments of recent years, and over the direction of current trends.

This is one of the all too rare occasions when the Board and its constituents step back and examine rail regulation and policy as a whole. In keeping with the broad scope of this proceeding, these comments focus more on overall policies and shipper concerns than on details of regulation such as specific mergers or narrow issues. In particular, PPL Utilities Corporation and PPL Montana LLC will reserve any specific comments on the proposed CN/BNSF merger for STB Finance Docket No. 33842.

I. INTEREST OF PPL ELECTRIC UTILITIES CORPORATION AND PPL MONTANA LLC

PPL Electric Utilities Corporation is the corporate successor to Pennsylvania Power & Light Company, an investor-owned electric utility headquartered in Allentown, PA. As owner and operator of large coal-fired electric generating stations in Pennsylvania, Pennsylvania Power & Light was a major coal shipper, and one of the largest, if not the largest coal shipper customers of the former Consolidated Rail Corporation. PPL Montana LLC is an affiliate of PPL Electric Utilities Corporation established to operate generating facilities recently acquired by PPL in Montana.

As a captive shipper, Pennsylvania Power & Light was vitally interested in the remedies available under the Interstate Commerce Act. Pennsylvania Power & Light filed two major rate cases against Conrail, the only railroad serving its coal-fired generating stations. The first of these cases, Pennsylvania Power & Light Co. v. Consolidated Rail Corp., ICC Docket No. 38186S, was the first case litigated under the stand-alone cost test. More recently, Pennsylvania Power & Light Co. v. Consolidated Rail Corp., et al., Docket No. 41296, was one of the three rate cases underlying the STB Bottleneck Decision.

Prior to filing the second of these rate cases, Pennsylvania Power & Light attempted to negotiate reduced rates with Conrail. Its response was "We would rather see you go out of business." One of the numerous anomalies of railroading is that the bigger the customer, the more it is taken for granted.

Pennsylvania Power & Light, along with many other coal shippers and other shippers and organizations, participated actively in virtually all of the ICC and STB rulemaking proceedings that created the current regulatory environment. The company also challenged a number of ICC decisions in the appellate courts, and defended others. For example, as PP&L, Inc., the immediate corporate successor to Pennsylvania Power & Light, the company intervened in support of the STB in the appellate case on judicial review of the Board's decision to eliminate consideration of product and geographic competition from market dominance determinations.

Because of their participation in the generation of electric power, PPL Electric Utilities Corporation and PPL Montana LLC (hereafter collectively "PPL") have firsthand knowledge of deregulatory initiatives as they have affected both rail transportation and electric power generation, transportation and distribution. The companies also have firsthand knowledge of the interrelationship between the railroad and electric industries.

A major reason for the active participation by PPL and its predecessors in so many ICC and STB proceedings over the last 20 years has been the realization that, if not constrained, railroads with market power over shippers will be able, on their own, to decide which of those shippers survive, and which ones fail. This same market power could also enable a railroad to induce shippers to purchase from or sell to favored locations, and discourage commerce with disfavored locations. These decisions should be made by buyers and sellers, not by transporters.

PPL's participation in this proceeding reflects that same fundamental concern, but the stakes today are higher than ever before. Competition has increased dramatically in the marketplace for electric power. Competition has decreased dramatically, and threatens to decline to an irreducible minimum, in the railroad industry. The conflict between these trends is clear, and unacceptable.

II. HISTORICAL BACKGROUND

A. The Early Years of Rail Regulation

Federal regulation of the railroad industry began in 1887 with enactment of the original Interstate Commerce Act. That same year also produced the original Sherman Antitrust Act. Federal economic regulation arose out of public reaction against abuses of market power by railroads and other large industrial concerns, including the Standard Oil Company, which controlled virtually all east-west oil transportation. Ironically, this proceeding was begun because of threats by the railroads to consolidate into only two major east-west rail carriers serving the U.S. and Canada.

The abuses that led to regulation were hardly minor. Then, as now, individuals, communities and regions depended for their success or failure on reliable rail service at reasonable rates, and railroads took advantage of shippers' vulnerability. Payoffs to state legislators and local judges rendered local remedies ineffective (not that bribery existed only outside Washington).

This was the period of the railroad robber barons, portrayed in such works as The Octopus, by Frank Norris. The railroad exploitation of Western grain shippers described in that book had a basis in real events involving the Southern Pacific. See Railroad Rates in The Octopus: A Literary Footnote, 64 J. Transp. Logist. & Pol'y 298 (1997).[1]

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[1] For an earlier antecedent concerning the regulation of monopolies, see The Wealth of Nations. Though considered the father of modern capitalism, Adam Smith held no illusions about the vulnerability of markets to manipulation inimical to the public interest:

> The interest of the dealers, however, in any particular branch of trade or manufacturers, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to level, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this order, ought always to

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For the next ninety years, railroad regulation developed in accordance with, and did much to create, what came to be regarded as the classic public utility model. Characteristic features were pervasive regulation, published tariffs that had the force of law, barriers to entry into the industry, prohibitions against expansions or reductions in service without ICC approval, and cost-based ratemaking. The principal purpose of the Act was said to be the prevention of discrimination.

The Interstate Commerce Act was the model for successors such as the Motor Carrier Act of 1935, the Natural Gas Act, the Federal Power Act, and the Federal Communications Act. Other Commissions were created, at the federal and state levels, as descendants of the Interstate Commerce Commission.

With enactment of the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980, the public utility model of rail regulation gave way to a new model.

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[1](...continued)

> be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

Wealth of Nations, Volume I, Book I, Chapter XI, Conclusion.

B. The Decline of Effective Regulation During the Last Two Decades

The 4-R Act and Staggers Act, in themselves, changed regulation in ways that shippers could generally live with. However, in its decisions implementing Staggers, the ICC went beyond the strict requirements of the law, and exercised its discretion in ways that dramatically changed the balance between railroads and their captive shipper customers. On issue after issue, railroad interests prevailed.

Because PPL is a rail customer, the following review reflects the customer's viewpoint, and more specifically, the viewpoint of a captive customer. Many of the decisions discussed were not made by the present STB or under present laws. They nevertheless constitute the context in which we find ourselves as we consider the prospect of further rail consolidation.

1. Revenue Adequacy

In a series of decisions in Ex Parte No. 393, Standards for Railroad Revenue Adequacy, the ICC adopted a definition of railroad revenue adequacy under which the railroads could plead poverty, and demand favorable regulatory treatment, despite achieving financial strength adequate for the funding of major acquisitions like those at the heart of the present inquiry. Though ignored by Wall Street and the railroads themselves, the Board's consistent but erroneous findings concerning railroad revenue inadequacy have served as tie-breakers in many other proceedings.

2. Rail Service

In the area of rail service, neither the ICC nor the STB has been a reliable or effective defender of minimal standards of performance by railroads.

- When grain car shortages became a serious problem in the 1980's, the ICC responded in three stages. First, it deprescribed the compensation the railroad industry must pay private car owners who supply half the nation's grain car fleet.[2] Second, it allowed the railroad industry to assign second class status to private cars, discouraging utilization.[3] Third, it allowed the railroads to exploit the shortages they created by under investing in cars and by giving preference to railroad owned cars through car auctions like the Burlington Northern "COT" program.[4]
- During the "meltdown" that followed the UPSP merger, the Board's exercise of its emergency powers was too little, too late.
- In the face of similar problems in the Northeast, the Board has opted for "informal remedies," and has

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[2] See, Lo Shippers Action Committee v. ICC, 857 F.2d 802 (D.C. Cir. 1988), cert. denied, 109 S.Ct. 2429 (1989).

[3] See, Shippers Committee OT-5 v. ICC, 968 F.2d 75 (D.C. Cir. 1992).

[4] See, National Grain & Feed Ass'n. v. Burlington Northern R. Co., et al., 8 I.C.C. 2d 421 (1992), aff'd in part and rev'd in part, sub nom National Grain & Feed Assn. v. United States, 5 F.3d 306 (8th Cir. 1993).

excluded operational problems from the scope of its just-announced Conrail Oversight proceedings.

3. **Rail Rate Issues**

Twenty years after enactment of the Staggers Act, too many shippers paying high rail rates (i.e., rates well above the threshold of regulatory jurisdiction) have no remedy whatsoever. Remedies are available only for a minority of captive rail shippers, and even these remedies are limited. Consider the following:

- When the ICC first developed regulations governing market dominance determinations, it developed workable rules relying on presumptions. Those were quickly discarded in favor of an approach that made market dominance determinations as costly as rate reasonableness determinations. The statutory requirement that competition be "effective" was ignored, and many shipper complaints were rejected based on vague allegations of "potential" competition. Recently, the Board took commendable corrective action.
- Three of the four constraints in "constrained market pricing," the maximum reasonable rate methodology adopted in Coal Rate Guidelines -- Nationwide,[5] are completely ineffective. They have never been used.

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[5] Coal Rate Guidelines -- Nationwide, 1 I.C.C. 2d 520 (1985), aff'd sub nom Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987).

- For years after enactment of the Staggers Rail Act, shippers of commodities other than coal had no remedy. The methodology adopted in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines -- Non-Coal Proceedings, has never been tried.
- Even if the methodology "worked," it could, at best, produce rate prescriptions at revenue levels well over 200% of variable cost.
- In implementing the statutory requirement of a mechanism for quarterly rail cost adjustments, the ICC adopted procedures that produced windfall profits for railroads. The initial RCAF suffered from a ratchet effect (i.e., rates went up with RCAF increases but not down with RCAF decreases). This was corrected, but the ICC then resisted for 9 years the adoption of a productivity adjustment to the RCAF. As a result, the railroads were able to base unchallengeable rate increases on increases in hourly wage rates, while ignoring the fact that their labor force was being cut in half. When a productivity adjustment was finally adopted, the RCAF-U was preserved, relegating many contract shippers to unjustified rate escalation. These arrangements were so generous that for a decade, hardly any rail tariff rate increases were published.
- In the Bottleneck Decision, shippers were required to litigate the reasonableness of entire through rates,

even where market dominance exists only for part of the route. The Board created a contract exception based on its lack of jurisdiction over contract rates, but held that its lack of jurisdiction in the absence of market dominance was trumped by equivocal 80 year old case law on railroad routing initiatives. As a result, rates for short stretches or for switching many exceed the threshold of jurisdiction by a factor of 10 with no remedy.

- Even the rate stability theoretically offered by contracts is unavailable where railroads refuse to enter contracts. BNSF resists using contracts for grain shipments. CSX recently announced that it would reduce its use of contracts. Switching to tariffs permits a railroad to increase its rates at will.

4. Rail Competition

The intent of Congress in the Staggers Act to deregulate in favor of competitive solutions has, since 1980, been applied to many other industries, including trucking, natural gas, telecommunications, ocean shipping, and electric power generation and sales, an area with which PPL is particularly familiar. However, competition among railroads has not been promoted, or even preserved.

- The last two decades have seen ICC decisions condoning wholesale cancellations of joint rates and through routes. See, e.g., Pittsburgh & L.E.R.R. v. ICC, 796 F.2d 1534 (D.C. Cir. 1980).

- In Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition, 1 I.C.C. 2d 822 (1985), the Commission adopted rules intended to prevent anticompetitive route cancellations (the so-called "Competitive Access Rules") at 49 C.F.R. Part 1144. These regulations have been useless, and the railroads have steadily used their power to foreclose shipper access to any routings other than those preferred by the railroads.

- The ineffectiveness of competitive access regulation was compounded by the interpretation of the statute in Midtec Paper Corporation, et al. v. Chicago and North Western Transportation Co., 3 I.C.C. 2d 171 (1986). Despite statutory language enabling the ICC (and the Board) to prescribe terminal trackage rights and/or reciprocal switching where "practicable and in the public interest," the Commission first imposed the additional requirement of a showing of market dominance as a prerequisite to relief, and then held that anticompetitive conduct is a prerequisite.

- The STB's Bottleneck Decision also serves to reduce competition among railroads, by enabling a railroad that may have actual market power over only a relatively short segment of a haul to leverage its market power. In this way, the railroad serving a power plant can foreclose access to competing carriers, and to mines served by other carriers.

- Competition between major railroads and short lines has been rendered ineffective by paper barriers in line sale contracts, and by the structuring of trackage rights agreements in such a way as to enable the larger railroad to isolate smaller ones, foreclosing access. Given this imbalance of economic power, it should come as no surprise that the recent AAR/ASLRRA agreement accomplishes so little.

5. Merger Proceedings

In ICC and STB merger decisions, as in too many decisions addressing other regulatory issues, the concerns of captive shippers have been given short shrift.

- Promises by the applicant railroads of public benefits have been credited, and warnings of adverse effects on competition have been brushed aside.
- Neither the ICC nor the Board has ever taken steps to prevent railroads from recovering acquisition costs from captive shippers.
- The ICC and the Board have used the "one-lump" theory to ignore all reductions in competition other than a reduction from two-railroad service to one-railroad service. Downstream and upstream losses of competition due to lost or impaired access to mines or other sources of raw materials, or to markets, are neglected, even

though such downstream effects are not explained away by the one-lump theory.

- No action has been taken to promote competition through conditions imposed on merging railroads, as is routinely done in merger proceedings before other agencies. The ICC and Board have attempted only to preserve pre-existing competition, and have fallen short of meeting that goal.
- All too often, the agency's response to complaints raised in merger proceedings about the conduct of the applicants has been that the issue should be raised elsewhere, in a rate case or a competitive access case. These alternative remedies are often ineffective.

III. THE COMBINATION OF DECREASING REGULATORY EFFECTIVENESS AND INCREASING CONSOLIDATION OF RAILROAD MARKET POWER HAS BEEN BAD FOR SHIPPERS, RAILROAD AND THE PUBLIC INTEREST

The four largest U.S. railroads -- UP, BNSF, CSX and NS -- are estimated to carry 95% of the nation's rail freight. Now that BNSF proposes to merge with CN, the other "big three," along with Canadian Pacific, say that if the BN/CN merger goes forward, they will have no choice but to engage in further consolidations. We are told that the result might be that in a few years, there will be only two major railroads in the U.S. and Canada.

The best way of analyzing the significance of these potential developments, and what to do about them, is to consider the course and impacts of the regulatory developments and consolidations that brought us to where we are today. We are well past the point at which mergers can be treated as "business as usual," since the Western U.S. and the Eastern U.S. are already served by only two major railroads.

During the last two decades, it is undeniable that shippers have lost regulatory protections at a time when the number of railroads has been shrinking, and the major railroads have grown larger and more powerful.

It would not be accurate to say that all of the decisions of the ICC and Board have favored railroads. The agency has done a generally good job with build-out applications, and certain types of shippers have a generally good record of success in rail rate cases, the Bottleneck setback aside. However, on balance, the scales have too often tilted in the railroads' favor.

Of course, the present Board is not responsible for all of the barriers to shipper relief discussed above. Some of these results were statutorily mandated. Others resulted from discretionary decisions that may be defensible when considered in isolation. But the cumulative result of the regulatory developments of the last two decades has been that many shippers have lost faith in regulatory remedies.

A. Shipper Interests Have Suffered Under Declining Regulation and Increased Rail Consolidation

Too many shippers whose rates are too high simply have no remedy. If they are small, rate cases are too expensive. If they are large, but ship to hundreds of destinations, such as plastics or chemical manufacturers or any other industrial shipper with a national market, rate cases are still prohibitively expensive. The stand-alone cost methodology can work for shippers of large volumes between a few origins and destinations. For everyone else, developing and costing a stand-alone railroad is prohibitively expensive. And the Bottleneck Decision can and will insulate from regulatory scrutiny rates that are far in excess of stand-alone cost for the line segment where there is market dominance.

Too many shippers whose service is inadequate are no better off. Neither the ICC nor the STB has been willing to require railroads to shoulder the burden of justifying their service levels as reasonable.

It should therefore come as no surprise that shipper recourse to the STB has fallen to the lowest levels in history. Shippers are not satisfied with the status quo. Last year's GAO report cited large numbers of complaints by shippers about rail rates and service. But many shippers are intimidated or experience railroad retaliation if they speak out. Others who are willing to stand up for their legal rights do not believe they can succeed.

B. Rail Interests Have Also Been Hurt by Consolidation and Inadequate Regulation

With rates and service effectively deregulated for all but a handful of shippers, have railroads benefitted? In other words, has captive shippers' loss been the railroad industry's gain?

The answer to this question is not simple. Clearly there have been some benefits from the railroads' freedom to decide for themselves, even on jurisdictional traffic, how high to raise rates and how much to reduce service quality. The financial health of the largest railroads certainly improved, at least until they experienced the self-inflicted wounds of the UPSP meltdown and current service problems in the Northeast.

But there have also been adverse effects on railroads. Small and regional railroads are struggling and many are likely to fail as major railroads pursue efficiency gains, such as heavier grain cars, that are beyond the means of smaller railroads. But even if the focus of the inquiry is limited to major railroads, there have been disappointments. For example, UP, CSX and NS all projected that their recent mergers would lead to the diversion of freight from truck to rail. Not only has this not happened, but the diversion of freight has been in the other direction.

The railroad parties to this proceeding will doubtless contend that the recent mergers have been better for their industry than preservation of Santa Fe, Southern Pacific, Conrail and Illinois Central as independent railroads, but this may not be the right question. In order to analyze the impact of rail consolidations on railroads it is important to consider the regulatory context.

Put another way, if the rail consolidations that have taken place to date had taken place in a context in which increasing railroad market power had been counterbalanced by effective regulation, competition, or a combination of both, what would have been the result?

Clearly, shippers would be better off. As for the railroads, the issue is whether their extraordinarily privileged situation has sheltered them from making the hard management decisions, implementing the technological innovations, and adopting the increased customer responsiveness that have been the hallmark of the rest of the American economy.

Lord Acton's observation (in 1887, as it happens) that "Power tends to corrupt, and absolute power corrupts absolutely" is true of economic as well as political power. For twenty years, the railroads have had the luxury of almost complete immunity from the antitrust laws, and almost complete freedom from regulatory interference. Even state laws are generally preempted. If they have not had the success that they and their shareholders wished for, the STB cannot be blamed. A more likely explanation is that the railroads have had things too easy for their own good.

The contrast with trucking is instructive. The trucking industry, like the railroad industry, was largely deregulated in 1980. As with railroads, ICC and STB trucking regulation has been "light-handed," to say the least. And yet the trucking industry has no captive traffic. Truckers have to compete for every pound of freight they haul.

There have been some problems in the trucking industry during the last two decades, with bankruptcies and thin profit margins. However, with the exception of special situations like household goods moves, NCC classification procedures, and rate bureau collective ratemaking, shipper complaints about trucking rates and service are virtually nonexistent.

Notably, the areas that do give rise to complaints are those where the industry is not subject to the market discipline that Congress called for as the "principal regulator of motor carriers." Central & Southern Motor Freight Tariff Assn. v. United States, 757 F.2d 701, 311 (D.C. Cir.), cert. denied, 476 U.S. 1019 (1985). That is, except for the limited areas in which they are able to operate like railroads, trucking companies have provided good service at good rates.

As Congress intended, motor carrier competition has kept most freight rates reasonable and has engendered significant improvements in service through new, more efficient business practices and through investments in new equipment and technology. Contemporaneous and complementary efficiency improvements by shippers and receivers and by the operators of warehouses and distribution centers have produced a revolution in the way truck freight is handled in America.

Even before the rise of e-commerce, shippers required, and motor carriers provided, innovations like reliable scheduled pickups and deliveries, expedited terminal services, consolidation and distribution, programs to reduce freight loss and damage, and electronic data interchange. As a result of these improvements and others like them, manufacturing and distribution are significantly more efficient than ever before.

Thanks to just-in-time motor carrier delivery schedules, inventories can be reduced dramatically. The construction, handling, maintenance and carrying costs that go with large inventories and the warehousing to store them can be avoided or minimized. Raw materials can be delivered to manufacturing facilities when needed, and finished goods can be delivered to wholesalers and retailers with enough dependability to minimize waste and under or over-production. Companies have moved beyond the management of separate purchasing, production, sales and distribution functions and have developed systems for integrated supply chain management. It is no exaggeration to say that the current economic boom enjoyed by this country could not have been achieved without these efficiency improvements by motor carriers and their shipper customers.

Now, of course, the internet is accelerating the pace of innovation, and demands on shippers and carriers. E-commerce, whether business-to-business or business-to-consumer, depends on rapid, reliable shipping and delivery, and new requirements are multiplying. The trucking industry is responding well. Plainly, much of the credit for this revolution in the efficiency and customer responsiveness of the trucking industry must go to that industry's personnel, at all levels from CEOs to drivers and mechanics. However, it is also clear that these service and rate improvements were driven by competition. Many trucking industry executives acknowledge that the revolutionary improvements in the quality of motor carrier service in the last two decades would not have taken place without the Motor Carrier Act of 1980.

The railroad industry may never be able to match the trucking industry for timely, reliable service. But in the view of too many rail customers, the rail industry does not even try. Surely, for example, it is easier to track trains than trailers. But for some years, shipment tracking over the internet has been available from trucking companies. And yet during the UPSP meltdown, entire trains would be lost for days or weeks.

The threat of losing business to competitors has been a powerful spur to innovation and improvement in the trucking industry. That same threat does not exist for railroads serving captive customers. Indeed, many shippers believe that as a result of the aggregate effect of the decisions and positions discussed above, shippers enjoy <u>less</u> rail-to-rail competition than is called for in the statute. And where railroads face neither competitive threats nor vigorous regulatory oversight, what incentive do they have for improvement?

C. <u>The Public Interest</u>

In assessing where the public interest lies, it is instructive to consider developments in other network industries. The contrast between rail and motor carriers has been addressed, but other industries have also experienced regulatory and commercial restructuring. Examples include natural gas pipelines, electric utilities, ocean shipping and telecommunications.

In <u>every case</u>, the public interest, as assessed by Congress, the regulatory agency, or both, was found to lie in the promotion of greater competition. And after more competition was found to exist, the regulators concluded that competitive forces should be permitted to operate, optimizing service and prices.

IV. WHERE SHOULD WE GO FROM HERE?

There is no reason to believe that the problems of the railroad industry and rail shippers cited above will be ameliorated if the number of major railroads serving the U.S. and Canada shrinks to two. On the contrary, there is every reason to believe that those problems will get worse. Among other things, rail-to-rail competition between the major railroads will decline. Not only will there be fewer Class I railroads to compete with each other, but many shippers will be located farther away from the tracks of a potential competitor. With such vast service territories, the resulting duopoly railroads will have every incentive to avoid vigorous competition for rail dependent traffic.

Short line railroads will also become less competitive, not more, as their survival depends on the good will of only one or two mega-railroads.

The "contract" exception in the <u>Bottleneck</u> Decision will become useless. Neither railroad will have an incentive to help shippers file rate cases against the other, given the risk of retaliation. Railroads too often refuse to consider service under a contract today. CSX recently announced that it would rely more heavily on tariff service, which permits unilateral rate increases and service reductions. This trend will continue.

Captive shippers will become more captive. Today, if PPL were to ship Powder River Basin coal to its Pennsylvania generating facilities, it could chose from among mines served by the BNSF and mines served by UPSP, selecting the best combination of mine and railroad based on price and service quality. But if NS (which serves PPL's Pennsylvania power plants) merges with, say, BNSF, PPL's ability to take advantage of competition for PRB coal and western rail service will be curtailed, if not eliminated.

In addition, there will be fewer situations in which shippers will be able to apply private sector remedies such as build-outs to break their captivity. Build-outs only work when a competing railroad is nearby. With fewer competing railroads in existence, fewer build-out opportunities will exist.

In the view of many shippers, PPL included, there is already too little competition among railroads. For this reason, simply calling a short or long-term halt in major railroad merger activity is not the answer. Nor does it make sense to postpone the consolidation of North American railroads down to two until some future time when such consolidation will be more convenient for the Class I railroads.

If there are to be further mergers among the major railroads, the regulatory and competitive context in which mergers are planned, reviewed and implemented must also change. In short, competitive solutions must be promoted as the preferred means of counterbalancing railroad market power. Where competitive solutions are impossible or ineffective, effective regulatory remedies must be made available. Only in this way will railroads have incentives approaching those that have produced so much progress in other industries.

Under current statutory law, the Board may lack the ability to implement all of the corrective measures that are needed. To the extent that this is the case, the Board should support sensible legislative reform. It should also refrain from criticizing shipper groups that have sought help from Congress. Given the circumstances discussed in these Comments, shippers understandably felt they had no choice but to pursue legislative remedies.

There are also, however, barriers to relief that result not from statutory commands, but from ICC or Board decisions interpreting and implementing statutory requirements that leave considerable room for the exercise of agency jurisdiction.

Many of the decisions discussed above that undermine the effectiveness of rail regulation were decided when there were more Class I railroads, or when the adverse impacts of recent mergers were not yet apparent. Assuming those decisions were reasonable (if not necessarily optimal) when made, it does not follow that they remain valid today, let alone if the number of Class I railroads shrinks to two.

At a minimum, a proceeding should be instituted to take public comments (not just railroad comments) on the paper barriers issue, and the Board should also reopen the following matters:

- the Bottleneck Decision
- Ex Parte No. 445, Intramodal Rail Competition
- Ex Parte No. 347 (Sub-No. 2), Rate Guidelines -- Non-Coal Proceedings

In addition, the Board should schedule an expanded inquiry into the procedures followed and issues considered in major rail merger proceedings. The agenda for this proceeding should include:

- elimination of the one-lump theory
- consideration of ways to promote competition, including through terminal and other trackage rights
- a requirement of reasonable rates to interchange points with other carriers
- protection against recovery of merger costs from captive shippers
- enforceable performance guarantees

Moreover, consideration of downstream impacts should be an integral part of proceedings to assess any future merger of Class I railroads.

The 24 business days permitted by the schedule in this proceeding are too short a time to provide detailed suggestions for needed improvements in law and regulation. In any event, Ex Parte No. 582 is not a rulemaking proceeding, and cannot, by itself, produce changes. However, the status quo is unacceptable, and major changes are required.

V. CONCLUSION

The Board may be tempted simply to declare a moratorium on merger activity. This would certainly please UP, CSX, NS and CP. However, from the point of view of PPL and other captive rail shippers, this would not be sufficient, and might not even be necessary. It is too soon to tell what innovations BN and CN may propose in their application that would address shipper concerns. Merger applicants are not compelled to minimize competitive remedies in mergers; that is simply what they have elected to do in recent proceedings. The task facing the Board is to consider the current state of rail regulation as a whole, to identify problem areas, and to restore a better balance between the interests of shippers and railroads.

Respectfully submitted,

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